GENERAL AGREEMENT ON
TARIFFS AND TRADE

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Committee on Balance-of-Payments Restrictions

REPORT ON THE 1982 CONSULTATION WITH PORTUGAL

1. The Committee consulted with Portugal in accordance with its terms of reference and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held on 23 June 1982 under the Chairmanship of Mr. J.N. Feij (Netherlands). The International Monetary Fund was invited to participate in the consultation pursuant to Article XV of the General Agreement.

2. The Committee had the following documents before it:

Basic Document	(BOP/226)
Secretariat Background Paper	(BOP/W/60)
IMF report "Portugal - Recent Economic Developments", dated 14 May 1982	

Opening Statement by the representative of Portugal

3. In his introductory statement, the representative of Portugal described recent developments in the Portuguese economy and the prospects for the remainder of 1982. A prolonged drought, with adverse consequences for agricultural and energy production, and a decrease in external demand had contributed to a slowdown in economic activity in 1981. GDP growth, which had been at a rate of 1.7 per cent in 1981, had resulted mainly from the expansion of services and, to a lesser degree, manufacturing. The drought, the reduction of subsidies for essential goods and the sharp depreciation of the escudo against the dollar had caused the inflation rate to rise to about 20 per cent.

4. The balance-of-payments had deteriorated sharply in 1981. The current account deficit had risen to 2.7 billion dollars, which represented 11.2 per cent of GDP compared to 5.2 per cent in 1980. The deficit in the trade balance had increased to 5.2 billion dollars. Imports had increased from 9.5 billion dollars in 1980 to 9.9 billion dollars in 1981 and exports had declined to 4.2 billion dollars in 1981, down from 4.6 billion dollars in 1980. The representative of Portugal said that the current account had also deteriorated because of a drop in tourism revenue and an increase in the cost of servicing the foreign debt. At the end of 1981, the Portuguese external debt had stood at about 10 billion dollars, which represented a rise of more than 30 per cent compared to the end of 1980.

5. In view of the strong imbalances which characterized the Portuguese economy, the government had, in July 1981, taken a series of monetary policy measures to restrain the domestic demand and to alleviate the pressures on balance of payments. Among these measures were a stricter control of domestic and external credit, a rise in interest rates and an increase in the banks' reserve requirements. At the end of 1981 the government had also increased the crawling peg depreciation from 0.5 to 0.75 per cent per month. The effective depreciation of the escudo in 1981 had been 6.4 per cent compared to 1.2 per cent in 1980.

6. As to the restrictive import measures imposed for balance-of-payments reasons, the representative of Portugal said that the proportion of imports subject to the 10 per cent surcharge was about 20 per cent of total imports in 1981. However, as a result of import tax exemptions granted for social and economic development reasons, only 10 per cent of total imports had in fact been surcharged. The 60 per cent surcharge had covered only 0.8 per cent of total imports in 1980. When the quota system on consumer goods was prorogated to 31 March 1982 some items had been taken off the list of restricted items and the total value of the import quotas had been increased by 50 per cent. This system was estimated to cover 0.9 per cent of the total imports in 1981. The value of quotas for unassembled motor vehicles had been raised by 14 per cent in 1981.

7. As to the prospects for 1982, the representative of Portugal said that in the first quarter of 1982 monetary policy had again been tightened: credit ceilings had been fixed at lower rates, the banks' reserve requirements had been raised, the discount rate had been increased to 19 per cent and the interest rates were set at higher levels. On 15 June 1982 the government had decided to devalue the escudo by about 9.4 per cent in effective terms in view of the exchange rate adjustments within European Monetary System. This measure aimed at restoring the external competitiveness of the Portuguese industry. A reduction of the public sector deficit was planned for 1982. The expected result of this policy was a slower rate of increase in domestic demand and a decline in inflationary pressures.

8. Debt service payments were expected to increase given the high interest rate levels and the size of Portugal's external debt. A large deficit in the current account was therefore expected also for 1982. Notwithstanding the fact that the Portuguese government had for this reason no option but to maintain the restrictive measures taken for balance-of-payments reasons it had been decided to increase the total value of quotas for consumer goods for the twelve months beginning on 1 April 1982 by 22 per cent and of the quotas for imports of unassembled motor vehicles in 1982 by 9 per cent. The surcharge scheme had not been changed. As to the 60 per cent surcharge, a special working party had been set up to study the adaptation of the indirect consumption taxes to the VAT scheme in force in the EEC.

Statement by the representative of the International Monetary Fund

9. At the invitation of the Committee, the representative of the International Monetary Fund made a statement, the full text of which is reproduced in the Annex.

Balance-of-payments position and prospects - alternative measures to resore equilibrium

10. One member, noting that the rate of inflation was 25 per cent per annum at the beginning of the year and that the recent depreciation was likely to create inflationary pressures, asked whether it was realistic to expect a decline in the inflation rate by the end of the year. The representative of Portugal replied that there were reasons to be optimistic. Agricultural production was expected to grow. Most wage settlements had already been concluded at the beginning of the year. They provided for an increase in wages of about 20 per cent and could not be easily adjusted to the actual rate of inflation. Moreover, restrictive monetary policies were leading to a decline in demand. All these factors taken together would help reduce the rate of inflation.

11. One member, noting that a large portion of foreign exchange earnings were spent on imports of agricultural products, expressed concern about the situation in the agricultural sector of Portugal. In response, the representative of Portugal said that the problems in this sector arose from structural difficulties, which could only be overcome in the long run. A sector plan was being developed with guidelines for policies to improve the situation in the agricultural sector.

12. One member noted that the budget deficit had been large in 1981 and would remain so in 1982. The strategy of the government appeared to be to restrain inflation in order to strengthen the external financial position. However, its efforts to reduce the budget deficit had not been effective and this had forced it to rely on credit controls, foreign borrowing and restrictive import measures. The member wondered what the current plans for controlling the growth of the budget were. The representative of Portugal said that one of the main objectives of his government was to reverse the deteriorating trend of the public finances. In 1981 the budget deficit had been 11.5 per cent of GDP, in 1982 it was expected to decrease to 8.5 per cent of GDP as a result of a marked decline in public consumption and transfers.

13. One member, noting that Portugal had a current account deficit of about 11 per cent of GDP, asked how the government intended to finance the deficit. The representative of Portugal said that his authorities pursued a flexible stragegy. Foreign capital markets could be easily tapped by Portugal. Recent experience had shown that Portugal was able to borrow at favourable terms, which reflected the confidence of investors in the Portuguese economy. The foreign debt burden of Portugal was not high compared to that of many other countries, although the rate of increase in indebtedness needed to be restrained. The possibility of obtaining resources from the International Monetary Fund by using several of its facilities was not excluded; in fact his authorities were presently discussing with the Fund the possibility of making use of the Fund's compensatory financing facility. The government was also promoting foreign direct investments, which had increased in 1981.

14. In reply to a question, the representative of Portugal said that interest rates were set by the Bank of Portugal and not by the free play of market forces. In answer to further questions, the representative of Portugal confirmed that the 9.4 per cent effective devaluation had been undertaken in addition to the crawling peg depreciations of presently 0.75 per cent per month. The 9.4 per cent devaluation together with the crawling peg depreciations were expected to lead to an effective depreciation of about 14 per cent from 1981 to 1982. This depreciation would be sufficient to restore the competitiveness of the Portuguese industry, as calculations on relative unit labour costs had shown.

15. One member, noting that the volume of Portuguese exports had declined in 1981, wondered to what extent the Portuguese balance-of-payments situation was affected by external factors, in particular by restrictive import measures by Portugal's main trading partners. The representative of Portugal replied that exports had mainly declined as a result of a worsening of Portugal's competitive position and a decline of external demand. However, the continued application of protectionist measures in the field of textiles had also had an adverse impact.

16. One member said that in general there appeared to be need for tighter fiscal controls, a reduction in the share of current expenditures in public spending, reduced subsidization of agricultural products and other basic commodities, and less government support for enterprises. Real interest rates needed to be made strongly positive so as to avoid capital outflows, attract emigrants' remittances and reduce the rate of inflation.

System, method and effect of the restrictive import measures

17. Many members of the Committee noted that, beyond the formal import quotas on some consumer goods and unassembled vehicles covering only a small portion of foreign trade, the procedures for issuing import registration certificates had, according to the documentation before the Committee, been the major non-tariff barrier against imports. These procedures had been informally used, both for protective and balance-of-payments purposes, as a discretionary barrier against imports, inter alia, of steel, paper, textiles, ceramics and food products. The members, stressing the need for transparency in import policies, expressed a strong interest in obtaining further information on this matter. These members regretted that the import registration certificates had been informally used for balance-of-payments purposes and expressed the wish that, if the certificates were to be used for balance-of-payments purposes in the future, the measures be notified to the GATT.

18. The Portuguese representative replied that the certificates were required for almost all imports and exports. They served statistical purposes and permitted the importer to obtain the necessary foreign exchange and to pass the goods through the customs. Normally the certificates were issued within the time frame necessary for completing all the procedural steps required under the law. Delays might have been caused by recent organizational changes in the government, in particular by the transfer in October 1981 of the jurisdiction over trade control policy from the Ministry of Trade and Tourism to the Ministry of Industry, Energy and Export and the Ministry of Agriculture, Commerce and Fisheries. The Portuguese authorities were ready to discuss bilaterally any problems that may have arisen.

19. One member, referring to paragraph 4 of document BOP/W/60, asked whether the Portuguese authorities could provide information on the import tax exemptions of which also part of the surcharged items benefitted. The representative of Portugal said that there was a very broad range of laws permitting import tax exemptions. There was legislation permitting duty-free imports of raw materials and capital goods. Other laws exempted certain entities from the payment of import duties, such as Air Portugal, the national railways, the tramways of Lisbon and the Red Cross. Imports for re-export, or for incorporation in goods for export, were also exempt from import duties. This applied in particular to components used by the electronics industries. All duty exemptions were granted independant of the origin of the imports. As a result of import tax exemptions, import tax revenue was in 1981 only 52 per cent of what it would have been in the absence of the exemptions. In the light of its forthcoming accession to the EEC, Portugal was presently reviewing the legislation permitting import tax exemptions.

20. Members of the Committee, referring to paragraphs 8 and 9 of BOP/W/60, expressed regret that the present quota system for consumer goods and unassembled vehicles had not been notified to the GATT. The representative of Portugal stated that this would be done as soon as the applicable laws were published. The quota system for consumer goods was probably going to be prolonged by one year to

31 March 1983 with no change in the product coverage and an increase in the total quota value by 22 per cent. The new system was about to enter formally into effect; in the meantime licences had been issued on the basis of the draft government order. The quota system for unassembled vehicles had been prolonged by a law establishing a restructuring programme for the automobile sector. This system, originally introduced for balance-of-payments reasons, was now an integral part of the automobile sector policy. The value of the quotas had been increased by 14 per cent for 1981, and by 9 per cent for 1982. These increases were sufficient to permit the maintenance of the import volume at 38,000 vehicles per year.

21. One member said that the surcharges and quotas were threatening to become a permanent feature of the Portuguese import policy and were undoubtedly incorporated into the expectations of protection underlying investment decisions. This was not consistent with the intent of GATT's balance-of-payments provisions. He urged the establishment of a time schedule for the removal of the measures as soon as possible. The removal of the measures in advance of Portugal's accession to the EEC would facilitate GATT consideration of that issue. He noted that the effect of the surcharges and quotas was much greater than the trade coverage would appear to indicate. This applied in particular to the 60 per cent surcharge, which was nearly prohibitive and therefore substantially reduced the share of total imports subject to it.

22. Members of the Committee expressed appreciation for the information provided by the representative of Portugal during the consultation and for the assurance given by him that the details of the quota system for consumer goods and unassembled vehicles would be formally notified to the GATT as soon as possible.

Conclusions

23. The Committee noted that Portugal's external position had deteriorated sharply in 1981 and that this had hindered further progress in the elimination of the surcharges and quotas on certain consumer goods. It also noted that the administration of the general import licensing system had become more restrictive. The Committee encouraged Portugal to pursue monetary and fiscal policies which would foster an improvement in the current account and allow a gradual elimination of the restrictive import measures and a more liberal administration of the import licensing system.

24. The Committee noted with concern that the surcharges and import quotas had now been applied for more than six years and that no time schedule for the removal of the measures had as yet been announced. The Committee considered it important to ensure that investors do not expect the measures to be permanent features of the import regime since this expectation would lead to a misallocation of resources and render the eventual abolition of the measures more difficult. The Committee therefore reiterated the recommendation made in previous consultations that Portugal announce a time-schedule for the removal of the restrictive import measures in the near future.

ANNEX

Statement by the Representative of the International Monetary Fund

Following the successful implementation of a stabilization program in 1977-78, the Portuguese economy experienced a marked improvement in its balance of payments. The main elements of the program were an adjustment in exchange rate policy to restore and maintain external competitiveness and a substantial increase in interest rates to promote savings and attract remittances. These policies succeeded in shifting the current account of the balance of payments from a deficit equivalent to 9 per cent of GDP in 1977 to near equilibrium in 1979, while at the same time facilitating, through a strong performance of exports, an acceleration in GDP growth from 3 per cent in 1978 to 4 1/2 per cent in 1979.

The easing of the external constraint encouraged the authorities beginning at the end of 1979 to take steps to ease the stance of financial policies with the primary objectives of stimulating investment and promoting the growth of real disposable income. As a result, real domestic demand increased by 7 per cent in 1980, while real GDP expanded by 5 1/2 per cent. At the same time, the authorities sought to dampen inflationary expectations through a 6 per cent appreciation of the escudo in February 1980 and through the postponement of a number of administrative price increases. These steps, along with a favorable harvest, secured a deceleration in consumer price inflation from 24 per

cent in 1979 to 16 1/2 per cent in 1980. The easing of the financial policy stance and the consequent upturn of domestic demand was quickly reflected in a renewed deterioration of the real external balance. This was compounded by a further sizable loss in the terms of trade mainly due to higher oil prices, leading to the re-emergence of a current account deficit of around US$1.2 billion or the equivalent of 5 per cent of GDP in 1980.

The easier stance of monetary and fiscal policy was continued until the second half of 1981 when policies began to be tightened as most interest rates were raised by 2 per cent, the credit ceilings were made more restrictive, some administered prices were increased, and steps were taken to contain the growth of public expenditures. Even though these measures succeeded in securing some slowdown, domestic demand for the year as a whole continued to grow at a faster rate than in Portugal's main trade partners. However, the growth of GNP slowed to 1 1/2 per cent in 1981 as output was unfavorably affected by a poor export performance and by the effects of a severe drought on agricultural production. Mainly reflecting an acceleration in food prices, inflation picked up to 25 per cent by year-end.

The external position deteriorated sharply in 1981 as the current account registered a deficit of about US$2.7 billion or the equivalent of over 11 per cent of GDP. Exports recorded a significant decline in volume terms, reflecting the stagnation of external demand, a worsening of the competitive position, and the effects of protectionist measures by industrial countries on some traditional exports, notably textiles. In the course of the year, the escudo depreciated in effective terms by 6.5 per

cent, a rate well below the differential in cost and price developments between Portugal and its trading partners. The current account position was also affected by a sizable loss in the terms of trade, the impact of drought on imports of agricultural products and energy, a poor performance of tourism and emigrants' remittances, and the rising burden of interest payments on external debt. Notwithstanding a sizable increase in external borrowing, the overall balance deteriorated significantly and gross official foreign exchange reserves declined by over US$250 million to below US$500 million or the equivalent of less than three weeks of imports by end-December; as of the same date, the gold stock amounted to 22.1 million ounces. In response to these developments, the authorities in December 1981 announced the stepping up of the average monthly rate of depreciation to 0.75 per cent.

As regards the outlook for 1982, there should be a slowdown in the growth of domestic demand on the assumption that the authorities attain their objectives of reducing the budget deficit by around 2 percentage points of GDP while, at the same time, securing a deceleration in the growth of the monetary and credit aggregates. Real GDP, however, would nevertheless increase by around 2 per cent in 1982, being sustained by the improvement in the real external balance that would result from the moving into phase of Portugal's domestic demand with that of its trade partners. The tightening of the policy stance as well as the moderation of import prices and a more favorable harvest, may also be expected to lead to some deceleration of inflation during the course of the year. However, despite an expected improvement in the terms of trade and some moderation in import growth from the high levels of 1981, the trade

deficit is expected to remain broadly unchanged from the 1981 level at around US$5 billion. A recovery is anticipated in earnings from nonfactor services, especially tourism, and from remittances. However, the positive impact of this recovery in the services account is likely to be approximately offset by the rapidly increasing interest payments on the external debt. On the whole, the current account deficit is expected to remain close to US$2.5 billion or over 9 per cent of GDP in 1982.

The deterioration of the external position since 1980 has hindered further progress in the elimination of import surcharges and quotas on nonessential items. Moreover, import licenses have been administered in an increasingly restrictive fashion. However, import policies are to be reviewed in the context of the planned accession of Portugal to the EEC. The Fund hopes that the improvement in the current account that would be fostered by the pursuit of a tighter policy stance would allow a more liberal administration of import licenses and establish the basis for a gradual reduction of trade restrictions.

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On June 16, 1982 the Fund was informed that following the recent exchange rate realignment within the European Monetary System, the Portuguese authorities have decided to devalue the escudo by 9.4 per cent in terms of effective exchange rate. No changes have been made in weights contained in the currency basket. The crawling peg system shall be maintained at the prevailing monthly rate.